Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Frusetta	Analyst:	Kimberly Pantoja	Bill Number:	AB 1174
Related Bills:	See Legislative History	Telephone:	845-4786	Introduced Date:	02/25/99
		Attorney:	Doug Bramhall	Sponsor:	

SUBJECT: Child Care Credit/25% of Amount Paid

SUMMARY

Under the Personal Income Tax Law (PITL), this bill would allow a credit equal to 25% of the amount of child care expenses paid or incurred during the taxable year for any child of the taxpayer.

EFFECTIVE DATE

This bill is a tax levy and would apply to taxable years beginning on or after January 1, 1999.

LEGISLATIVE HISTORY

AB 149, AB 401 (1999/2000); AB 2026 (97/98); AB 90, AB 183 (95/96); AB 26, AB 66, SB 39 (93/94)

SPECIFIC FINDIGS

Existing federal law allows a credit against tax equal to 20% to 30% (depending on the taxpayer's adjusted gross income) of employment-related costs of care for a qualifying individual. A qualifying individual is defined as a dependent of the taxpayer who is under the age of 13 or a dependent or spouse who is physically or mentally unable to care for him- or herself. Employment-related expenses are defined, generally, as those expenses incurred to enable gainful employment.

Existing federal law limits the qualifying amount of employment-related expenses incurred during a taxable year to $2,400, if there is one qualifying individual, or $4,800, if there are two or more qualifying individuals with respect to the taxpayer for that taxable year.

Prior state law allowed a similar credit based upon expenses for household and dependent care services necessary for gainful employment. That credit was a percentage of the federal credit; the percentage was based upon the taxpayer's adjusted gross income (AGI) and ranged between 15% and 30%. That credit provision was repealed by its own terms December 1, 1993.

Prior state law allowed a $1,000 credit to any qualified parent who filed as a head of household, a surviving spouse, or married filing jointly, and claimed a dependent child who had not reached the age of 13 months. The qualified parent (or spouse in the case of a joint return) could not have earned income.

Board Position:			Department Director	Date
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The $1,000 was reduced for surviving spouses or married taxpayers if the spouse’s income exceeded certain levels. This credit was allowed in 1991, 1992, and 1993.

This bill would allow a credit for an amount equal to 25% of the amount paid or incurred for child care for any child of the taxpayer. Since this bill does not specify, any minor child, through age 17, would be included.

This bill would allow a carryover of any portion of this credit that exceeds the taxpayer’s tax liability until the credit is exhausted. Since this bill does not specify otherwise, the general rules in state law that apply to the division of credits among two or more taxpayers would apply. This credit would not reduce regular tax below tentative minimum tax for purposes of alternative minimum tax.

Policy Consideration

This bill does not specify a repeal date or limit the number of years for the carryover. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness. However, if a repeal date were added, the department would be required to retain the carryover on the tax forms indefinitely because unlimited credit carryover is allowed. Recent credits have been enacted with a carryover limit since experience shows credits are typically used within eight years of being earned.

Implementation Considerations

The department has identified the following implementation concerns. The author's staff has indicated the bill is in "spot bill" format and would like to work with the department staff to resolve these and other concerns that may be identified.

This bill uses the term "child care"; however, this term is not defined in the bill. It is unclear, for example, if "child care" includes expenses, services and/or payments to related individuals. In addition, the child care expenses are not related to the taxpayer's employment. Once the term has been developed, it would be helpful for the department if taxpayers were required to keep substantiation for the expenses as significant usage of the credit is anticipated.

The bill does not require the credit to be claimed only with respect to the taxpayer’s dependent children. Therefore, it appears that both divorced parents could claim the credit on the same child if each has child care expenses. Clarification is needed if this is not the author’s intent.

FISCAL IMPACT

Departmental Costs

Once the implementation concerns are resolved, this bill should not significantly impact the department’s costs.

Tax Revenue Estimate

Based on the data and assumptions below, order of magnitude revenue losses are projected as follows:

Effective On Or After January 1, 1999 (in millions)		
1999-0	2000-1	2001-2
($1,840)	($1,650)	($1,710)

The estimate for the first fiscal year above includes all of the 1999 tax year impact plus 15% of the 2000 year impact.

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

Revenue losses under the Personal Income Tax Law would depend on costs incurred by parents for child care and the amount of tax liability that would be available to apply credits.

In deriving the order of magnitude revenue impacts, the following assumptions were made (1) the annual cost per child would be $2,400, based on the qualifying amount of employment-related expenses allowed under the federal child care credit; and (2) only dependents that qualify taxpayers for tax exemptions would qualify.

The above estimates were derived from the department's personal income tax model adjusted to reflect the above assumptions. For the 1999 tax year, approximately 2.4 million returns would have tax reductions of $1,590 million and have $25 million in carry-over credits to apply in future years. These estimates are conservative since the bill does not limit the credit to custodial parents or limit qualifying expenses.

BOARD POSITION

Pending.